

Macro Prudential Toolkit: Measurement and Analysis

Financial Stability Risk Measurement

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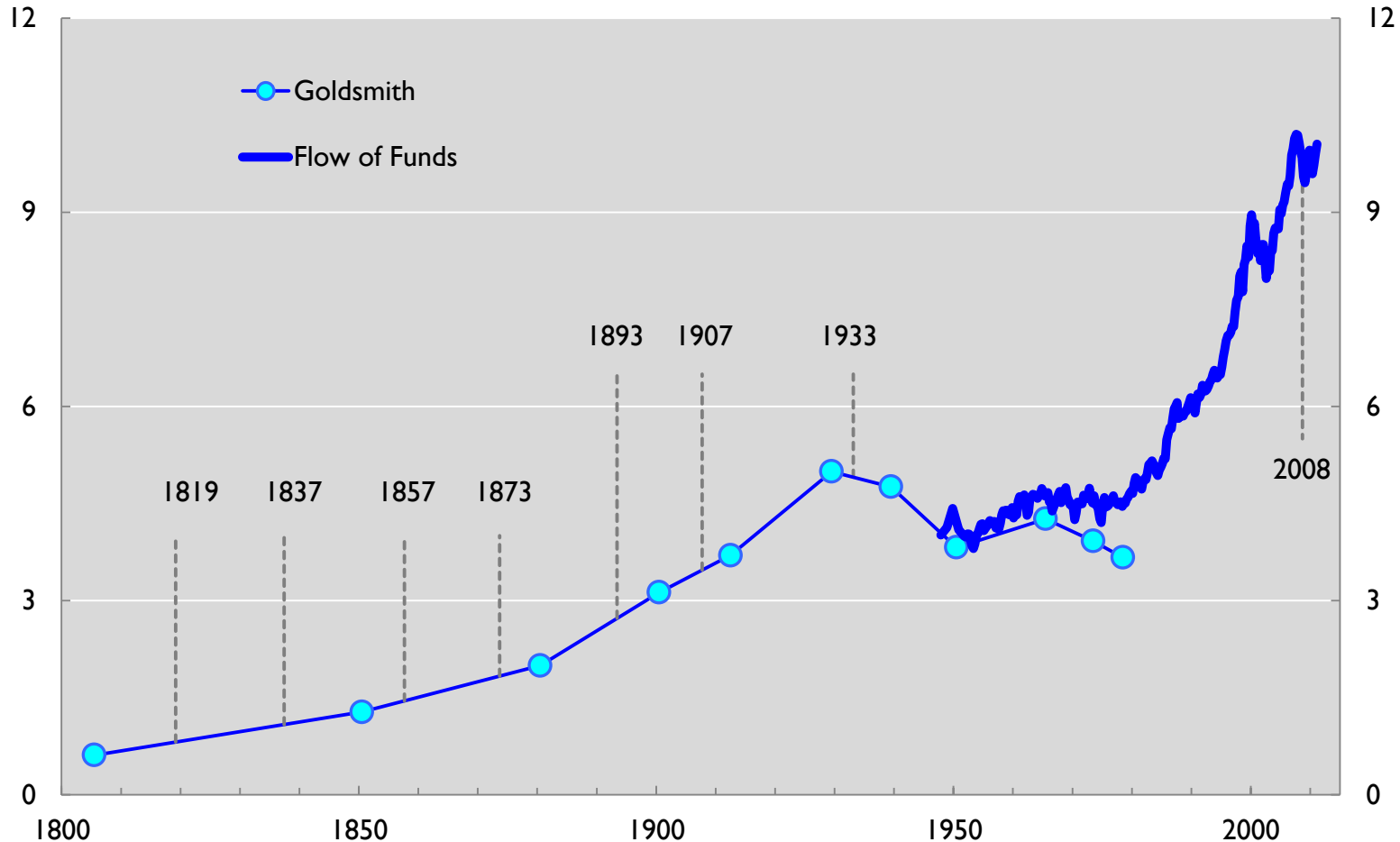
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Key Issues

- Systemic crises are rare events, relative to the pace of evolution of the financial system.
 - Measurement systems must be robust to innovation and evolution.
- We must take the practical side of measurement seriously.
 - The best theory is useless unless it can be implemented.
- Improving financial reporting at the level of the transaction is critical.
 - This will improve internal risk management, market discipline AND the measurement of systemic risk.

Growth of Finance and Systemic Crises

United States, Ratio of the value of all financial assets to GDP



Source: Goldsmith (1985) and Federal Reserve, Flow of Funds.

Looking Under the Street Light

- Researchers have been creative in developing a wide variety of techniques that are helpful for assessing systemic risk.
 - The focus has, rightly, been on what's possible within existing constraints.
- But we do not have robust models of systemic risk, and financial data are deeply flawed for this purpose.
- Existing empirical techniques offer only indicators of systemic risk, not direct measures of it.
 - We must always remember that the measures we have are only indirect proxies for the things we really care about.
- We must also remember that we need to do more than look for a recurrence of what has happened in the past.

Disclosure Appendix A1

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